SUPREME COURT OF THE UNITED STATES.

No. 123.—October Term, 1926.

The United States of America, Appellant, *vs.* The Shelby Iron Company of New Jersey, and the Shelby Iron Company of Alabama.	Appeal from the United States Circuit Court of Appeals for the Fifth Circuit.

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[April 11, 1927.]

Mr. Chief Justice Taft delivered the opinion of the Court.

This is a controversy over priority of equities in fifteen acres of land in Alabama, with a wood distillation plant thereon, between the United States and the Shelby Iron Company of New Jersey. The case involves the construction of a contract between the United States and the Shelby Chemical Company, on the one hand, and of a contract between the latter and the Shelby Iron Company of New Jersey, on the other. The first was for the construction and operation of the plant on the land to be conveyed by the Chemical Company to the Government with money to be furnished by the latter for the production of acetate of lime and methyl alcohol for use in the War. The second was entered into between the Chemical Company and the Shelby Iron Company of New Jersey in anticipation of the first. The Iron Company agreed to convey to the Chemical Company the needed land which was near the works of the Iron Company, and to furnish hard wood, water, workmen's houses and power necessary in the operation of the plant. The benefit which the Iron Company was to derive from the arrangement was the cheapness of cost in the charcoal to be made by the Chemical Company as a by-product of the process of distillation, and to be sold at a fixed price to the Iron Company for use in its blast furnaces situated in a large tract of timber land of which the Iron Company was the owner, and of which the fifteen acres here in question was a part.

The Chemical Company executed a warranty deed of the fifteen acres to the Government in intended compliance with its contract,

but the Iron Company had failed to convey the land to the Chemical Company as agreed by it. A deed was actually executed to the Chemical Company by an Alabama Company of the same name instead of the New Jersey Company that owned the land. The Alabama Company, a former owner of the land, was then an inactive company, the stock of which was owned by the New Jersey Company, and the directors in the two companies were the same. So the Government legal title failed for misdescription of the grantor.

This suit was a bill in equity to quiet title to the United States against the two companies, the Alabama Company and the New Jersey Company. The New Jersey Company relying on the misdescription answered and denied the title of the United States. Thereupon the Government amended its bill and asked that the deed be reformed. Then the New Jersey Company, which we shall hereafter call the Iron Company, answered by a recital of facts which, it claimed, showed that it has an equity in the fifteen acres of land stronger in right than that of the United States. This constitutes the issue in this case, for the mistake and misdescription are admitted and the right of the United States for reformation of the deed is conceded but for this claim.

The contract between the Iron Company and the Chemical Company was made April 8, 1918, and provided that the Iron Company should by warranty deed, free of all liens and encumbrances, for a nominal consideration, provide sufficient ground on which to build the plant of the Chemical Company. By subsequent clause, it says: "Inasmuch as the United States Government will be financially interested in the construction of the Chemical Company's plant, it is expressly agreed that such real estate may be deeded to and vested in the United States Government during the period of a contract made between the Chemical Company and the United States Government; said contract to extend for the duration of the War; and further" it is understood that the Chemical Company is about to construct its plant under a contract with the United States Government, by the terms of which the Chemical Company is to take the ownership of the land, buildings, equipment and improvements, if an enabling statute to that effect shall be passed by the Congress of the United States. Therefore it is distinctly agreed that the foregoing provision as to reconveyance

of the lands is subject to the obtaining of the title to said lands by the Chemical Company from the United States Government.

By the eighth paragraph, it was provided that the contract should last until April 1, 1933, with the right of the Iron Company to extend it further for five years upon notice to the Chemical Company; and that at the end of the contract, or its renewal, the Chemical Company should reconvey to the Iron Company all of the lands conveyed to it by the Iron Company without cost to it, free and clear of any encumbrances or liens whatsoever, or if there were any mortgages on the same not yet due, the Chemical Company should pay over to the Iron Company the amount thereof or the amount of any bonds outstanding thereunder, with any accrued interest thereon, and should, if the Iron Company so elected, sell to it all the improvements, equipment and other personal property placed on the lands of the Chemical Company.

Thereafter, on April 28, 1918, the government contract with the Chemical Company was made. It was estimated that the plant would cost over $400,000, which the United States agreed to advance and reimburse itself by deductions from payment to be made from the sale by the Chemical Company to the Government of the acetate of lime and the methyl alcohol.

Among the preliminary recitals in the contract is this:

"Whereas the contractor has a contract with the Shelby Iron Company of Shelby County, Alabama, according to the terms of which the Shelby Chemical Company shall receive all the lumber it may require from timber land owned and leased by the Shelby Iron Company in return for all charcoal derived therefrom".

This recital becomes important on the question of notice hereafter to be considered.

The Government contract in its first Article provided that the Chemical Company, the contractor, was to convey to the United States a tract of land at Shelby, Alabama, of adequate size and suitable location, for the erection of the plant thereafter described. The conveyance was to be made subject to and upon the completion of an opinion by the Attorney General that by the conveyance the Government would derive an absolute title to the premises in fee simple, free and clear of all encumbrances, and that the United States should have the right to expend money for the erection of improvements thereon.

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By Article II the contractor agreed to erect and construct for the Government on the land a properly equipped wood chemical plant with a certain capacity, to be completed in five months, to be paid for by the Government at cost, the particulars of construction to be embodied in a separate contract.

The third Article provided for the retention of 40 per cent. of the price of all sales to the Government for the products of the manufacture to yield 6 per cent. interest on the government investment in the plant and to constitute a depreciation and amortization fund for the benefit of the Government.

By the fourth Article the contractor agreed to sell and deliver to the Government the entire output of the acetate of lime and the methyl alcohol, and the Government agreed to buy it, during a period of 18 months and then for the duration of the War, at certain agreed prices and on certain conditions.

By the sixth Article it was provided that when the depreciation and amortization fund and the purchase fund provided should together equal the cost to the Government, with interest at 6 per cent., of the Government's investment, or at any earlier date at the option of the contractor, the Government should sell to the contractor, and the contractor should purchase the plant, machinery and equipment at the then fair market value to be fixed by appraisement. The obligation of the Government to sell the plant was conditioned upon its having legal authority to make such sale and conveyance.

Article VII provided that the Government might take possession of the plant and operate it on failure of the contractor to comply with the terms of the contract, but its right to operate should cease and terminate at the end of the War. If at that time the sale of the plant to the contractor should have been consummated, the Government was to surrender possession to the contractor, and if the plant was then still owned by the Government, it should at its own expense, within six months from the end of the War, remove all buildings and equipment constituting such plant from the ground upon which the same were erected, and should without further consideration reconvey such ground to the contractor.

Article 17 provides that in the event of an armistice, the Government at its option might terminate the agreement, but in such event the contractor should receive from the Government the un-

paid purchase price of the product then actually manufactured, and the contractor should receive further from the Government a sum sufficient to protect him against his actual net expenditures and actual net outstanding obligations incurred in the manufacture. Then the value of the plant, machinery and equipment should be determined by appraisal, as already provided, and the Government should sell and the contractor should purchase the plant and equipment at the appraised value; and in making the settlement the contractor should be given credit on account of the purchase price for the 35 per cent. of the purchase price of the products theretofore sold to the Government and by it retained for security.

After the plant had been partially constructed, and $260,000 was still owing to the Government from the Chemical Company, a new contract was made between them dated January 25, 1919, whereby the Government should become the absolute owner of the property free of all claims, and the Government should lease to the contractor for three years the property, the contractor to pay to the Government $50,000 down on account of the rental, and in one year $50,000 more, and in two years $75,000, and in three years $85,000, all of which was to apply as rental for the property. The company was to pay all the taxes. It was further provided that should the contractor complete the plant, then at the expiration of the three years the Government, for the consideration of one dollar, would convey the whole property to the contractor or should the contractor, not being then in default for any unpaid payments required to be paid by it under the terms of the contract, desire at any time to purchase the property, the Government would sell it for a sum equal to the difference between $260,000 and the total sum of rents then paid. It was agreed in the contract that should the contractor at any time default in any of the payments required to be made to the Government in the lease, the Government might waive such default or treat and regard the lease and obligation and privilege to purchase as forfeited, or treat and regard the lease as a continuing legal and binding obligation, but the obligation and privilege to purchase was to be forfeited.

The president of the Iron Company denies that it had knowledge of this second contract. The plant was completed under the second contract, and charcoal was made and delivered to the Iron Company till 1922 in March. The Government took over the plant in De-

cember, 1922, and the Chemical Company became a bankrupt in 1923.

It is clear that the effect of the purported contract of lease of January, 1919, was that of an equitable mortgage. The rentals to be paid were the installments of the amount due under the original contract from the Chemical Company for the amount of money which the Government had advanced, less that which it had already received, and upon payment of the rental stipulated, the title was to revert to the Chemical Company, while the Government reserved the power to take over the property in case of default or bankruptcy of the Chemical Company. Its default gave to the Government the right to enforce against the land and the plant the debt due under this equitable mortgage. *Peugh* v. *Davis*, 96 U. S. 332, 336; *Robinson* v. *Farrellt*, 16 Ala. 472, 75 Ala. 109, 111; *Moses* v. *Johnson*, 88 Ala. 517, 520; *Love* v. *Butler*, 129 Ala. 531, 537, 538.

The remedy which we think the Government is entitled to, unless it is to be defeated for the reasons about to be examined, is not the reforming of a deed and a decree compelling the Shelby Iron Company of New Jersey to substitute its own deed to the Chemical Company for the useless and void deed of the Shelby Iron Company of Alabama. It is rather to give to the Government leave to reframe its pleadings so as to set up therein its ownership of an equitable mortgage upon the land and the plant to be enforced by a sale thereof and the proper distribution of the proceeds. Of course we might affirm the action of the Circuit Court of Appeals with a provision in the affirmance that it should be without prejudice to the beginning of an original suit by a new bill in equity setting forth the equitable mortgage as against the Iron Company, and asking its enforcement, and, if need be, its foreclosure against the land and the plant. We think, however, that it is wiser and better and shorter to end the litigation in this one proceeding.

The Iron Company objects to this action by the Court, on the ground that it has conflicting equitable rights that should defeat any recovery under the alleged mortgage. It insists that under the original contract as construed in the light of its contract with the Chemical Company, the title of the Government to the land and plant, even if it had been perfected as a legal title, was to

terminate at the end of the war, and that the Iron Company was entitled as against the Chemical Company and the Government to the reconveyance of the land. It further insists that the Government knew of this limitation upon its right to retain the ownership of the property as shown in the contract between the Iron Company and the Chemical Company and that its only security was in the power reserved to it by the original contract between it and the Chemical Company to remove from the land the plant within six months and this it has not exercised and refuses to do so. It shows that it expended $50,000 in preparing for the changes due to the installation of the plant by the Government and has suffered loss by failure of the Chemical Company to comply with its contract. It further says that the fifteen acres of land is so related to the larger tract of which it was a part that its use and control is essential to its operation of its blast furnace, and that it offered to pay the balance of $210,000 for the transfer of the Government's whole interest in the land and plant to it. It urges that as between it and the Chemical Company, it became entitled to a reconveyance and to take possession of the land because of the breach and bankruptcy of the Chemical Company as a termination of the contract as if it had expired by limitation. This presents an issue as to the notice which the Government had of the Iron Company's claim under its contract.

The argument of the Iron Company is that the recital in the government's contract that the Chemical Company would receive under a contract with the Iron Company all the lumber it might require from timber lands of the Iron Company in return for all charcoal derived therefrom, put the United States on notice of everything contained in the contract between the Chemical Company and the Iron Company in respect of the title to the land and the future plant. It relies on the principle that the law imputes knowledge when opportunity and interest, coupled with reasonable care, would necessarily impart it, and that where one paper refers to another paper within the power of the party, it gives notice of the contents of the other paper to that party. We have no quarrel with this rule as to constructive notice, but we do not think that it applies here. The reference in the first paper to require examination of the second must be one that indicates that both are dealing with a subject matter to which inquiry would be

relevant. Here the relevant object of the injuiry would have been the title to the land and the plant upon it. The recital does not refer either to the land or the title to it, but to the furnishing of wood by the Iron Company. To charge one with notice, the facts must be such as ordinarily to excite inquiry as to the particular fact to be elicited. *Rogers* v. *Rawlings*, 298 Fed. 683; *Muller* v. *Engell*, 75 Ky. 441; *Hyde Park Supply Company* v. *Peck-Williamson Heating Company*, 176 Ky. 513; 2 Pomeroy's Eq., section 629, pp. 1208, 1209.

We think, therefore, that the question of notice must be reexamined and that the issue must be not of implied notice but of actual notice. It was contended that one of the officers acting for the Government was in such a position that he probably knew what the contents and the effect of the contract between the Iron Company and the Chemical Company was in reference to the tenure of the Government in the land, and that the fact that he was not called to testify on the subject was a circumstance tending to sustain the claim that the Government had actual notice. The Iron Company will have the opportunity to present this and other evidence to the trial court upon the issue of such actual notice when the pleadings are reframed.

Counsel for the Government make a further argument to show that even if the Government had had notice of the contents of the contract between the Iron Company and the Chemical Company, its purpose and effect could not in any way impair the effect of the equitable mortgage the Government acquired under its second contract and so-called lease to the Chemical Company. They say that the Iron Company in its contract with the Chemical Company, and in its 8th paragraph thereof, manifests clearly an expectation and consent that the Chemical Company might encumber the land and the plant with liens or mortgages, and relied only on the credit and obligation of the Chemical Company in reconveying to the Iron Company, to clear off mortgage liens or bonds which the Iron Company evidently thought the Chemical Company might create. If this is the correct view, an equitable mortgage of the Government of the land and the plant in which it had an interest to the extent of $260,000, must be clearly superior to the equity of the Iron Company growing out of the obligation of the Chemical Comyany to reconvey the land to the Iron Company. Neither the District Court nor the Circuit Court of Appeals considered this phase of the

case. It may not have been presented to them. Their consideration was chiefly given to the issue of misdescription and to the meaning of the clauses providing for reconveyance of the land and improvements by the Government in the contract between the Government and the Chemical Company. We do not now consider and pass upon the contention of the Government in these regards. We only refer to it to have it clearly understood that when the cause goes back, nothing in what we have said shall prevent a showing of actual notice to the Government of the claim of the equity of the Iron Company in the land by virtue of its contract with the Chemical Company on the one hand or the construction of the 8th paragraph of that contract as a reason for maintaining the priority of the Government's equitable mortgage, whether it had notice of the Iron Company's contract or not, on the other.

The decree of the Circuit Court of Appeals will therefore be reversed and the cause remanded to the District Court for a reframing of the pleadings and for further proceedings not inconsistent with this opinion.

A true copy.

Test:

Clerk, Supreme Court, U. S.